

MULTIMEDIA



UNIVERSITY

STUDENT ID NO

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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2015/2016

BAC3624 – ADVANCED AUDITING

(All sections / Groups)

5 MARCH 2015
2.30 p.m – 5.30 p.m
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of 6 pages with 5 questions only.
2. Attempt ALL FIVE questions. All questions carry equal marks and the distribution of the marks for each question is given.
3. Please write all your answer in the Answer Booklet provided.

Question 1

(a) Henry Sdn Bhd., a company trading in diamonds and other precious stones intends to appoint Eve & Co a firm of Chartered Accountants to audit its financial statements for the year ended 30 June 2015. The company intends to terminate the services of their existing auditor Adam & Co. as the company was not satisfied with the services provided by Adam & Co. The company was under the impression that the audit work carried by Adam & Co was too detailed and interfered excessively with the company's routine office work and operation. Eve & Co asked the company, Henry Sdn Bhd., to inform Adam & Co of their decision to change the auditor.

Required:

Discuss the *procedures* that Eve & Co should follow so that they will not be violating the By Laws (on Professional Ethics, Conduct and Practice) of the Malaysian Institute of Accountants (MIA).

(10 marks)

(b) The independence of an auditor should not be compromised when the auditor is providing non audit services to an audit client.

Non audit services which an auditor may provide include:

- (i) Taxation – preparing the company's tax computation and representing the company in negotiations with the Inland Revenue.
- (ii) Preparing monthly management accounts for the company and also quarterly and annual financial statements.
- (iii) Advising the directors on legal and accounting matters regarding additional finance for the company; advising on changes in share ownership and capital structure of the company

Required:

In relation to a private limited company (Sdn Bhd.) of which you are the auditor, you are required to consider the extent to which providing each of the above services may compromise your independence and the steps that you would undertake to minimise the risk to your independence in providing these services.

(10 marks)

(Total: 20 marks)

Continued...

Question 2

Kassim Baba Sdn Bhd operates a chain of food wholesalers across the country and its year end was 31st December 2014. The final audit is nearly completed and it is proposed that the financial statements and audit report to be signed on 15 March 2015. Revenue for the year is RM88 million and profit before taxation is RM17.8 million. The following events have occurred subsequent to the year end.

Receivable

One of long time Kassim Baba Sdn. Bhd.'s customer has been experiencing cash flow problems and its year-end balance is RM0.6 million. The company has just become aware that its customer is experiencing significant going concern difficulties. Kassim Baba believes that as the company has been trading for many years, they will receive some, if not full, payment from the customer; hence they have not adjusted the receivable balance.

Lawsuit

A key supplier of Kassim Baba Sdn Bhd. is suing them for breach of contract. The lawsuit was filed prior to the year end, and the sum claimed by them is RM2 million. This has been disclosed as a contingent liability in the notes to the financial statements; however recent correspondence has just arrived from the supplier indicating that they are willing to settle the case for a payment by Kassim Baba Sdn Bhd of RM1.6 million. It is likely that the company will agree to this.

Warehouse

Kassim Baba Sdn Bhd. has five warehouses; following extensive rain at the end of January 2015 the river water flooded the warehouse located in Ketereh. All of the inventories was damaged and has been disposed of. The insurance company has already been contacted. No amendments or disclosures have been made in the financial statements.

Required:

- (a) For each of the three events above:
- (i) *discuss* whether the financial statements require adjustment (6 marks)
 - (ii) *explain* the audit procedures that should be performed in order to form a conclusion on the adjustment; and (6 marks)
 - (iii) *explain* the impact on the audit report should the issue remain unresolved. (4 marks)

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- (b) Assume that the date is now 20 March 2015, the financial statements and the audit report have just been signed, and the annual general meeting is to take place on 10 April 2015. The Environmental Agency has issued a report stating that Kassim Baba Sdn Bhd is in breach of environmental legislation and a fine of RM3 million will now be imposed on the company. The amount is material to the financial statements. *Explain the additional audit work the auditor should carry out in respect of this fine.*

(4 marks)

(Total : 20 marks)

Question 3

The auditors of Meranti Engineering Bhd., a large engineering company are now in the course of auditing the company's financial statements for the year ended 30th of June 2015.

At the audit briefing meeting, the audit manager made the following statements:

(i) "whilst we are all aware of the benefits that Meranti Engineering Bhd. should have gained from using a computer-based accounting system, we need to be alert to the specific risks that a computer-based accounting system poses to an entity's internal controls."

(ii) "we will be using audit software."

Required:

- (a) State the benefits that Meranti Engineering Bhd. would have gained from using a computer-based accounting system(CAAT) .
(6 marks)
- (b) Discuss the risks posed by a computer-based accounting system to an entity's internal controls.
(6 marks)
- (c) Explain the term '*audit software*'.
(2 marks)
- (d) Briefly discuss FOUR functions performed by audit software and for each function suggest how it could be used for a specific task by the external auditors of Meranti Engineering Bhd.
(6 marks)

(Total : 20 marks)

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Question 4**Part 1**

- (a) In the context of *Audit Sampling and Other Selective Testing Procedures*, explain and provide examples of the terms 'sampling risk' and 'non-sampling' risk.

(6 marks)

- (b) Briefly explain how sampling and non-sampling risk can be controlled by the audit firm.

(2 marks)

Part 2

Haykal & Co is the Auditor of Cherry Chung Sdn Bhd., a company that trades in health care and cosmetic products. Upon the completion of the audit, the auditor supplied Cherry Chung Sdn Bhd. with 25 copies of the audited financial statements. The audit firm is aware in a general way that Cherry wanted that number of copies of the auditor's report to furnish to banks and other potential lenders.

The financial statements in questions were misstated by approximately RM800,000. Instead of having a net worth of RM700,000, the company in actual fact is insolvent. The management of Cherry Chung Sdn Bhd. has falsified some of the books and audit evidence to avoid bankruptcy. The assets had been overstated by RM700,000 of fictitious investments and RM100,000 of expired inventory. The audit had failed to detect these fraudulent entries. Tony Leung, a major supplier relied on the audited accounts and extended a loan of RM350,000 to Cherry Chung Sdn Bhd. A few months later, Cherry Chung Sdn Bhd. was found to have a going concern issue and unable to pay Tony Leung (the supplier). Tony Leung then seeks to recover his loss from Haykal & Co. as he claimed that the basis of on which he extended the credit of RM350,000 to Cherry Chung was due to the fact that he relied on the audited financial statement.

Required:

- (a) *Discuss* the significance of the *Caparo* case with respect to auditor's liability to third parties.

(4 marks)

- (b) Will Tony Leung the supplier be able to recover his loss from Haykal & Co.? *Discuss*

(8 marks)

(Total: 20 marks)

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Question 5

Odi Turbo Bhd. sells imported cars, car spare parts and offers service/maintenance from 25 different locations in Malaysia. Each branch has up to 25 staff and most of the accounting systems are designed and implemented from the company's head office. All accounting systems, apart from petty cash, are computerised, with the internal audit department frequently advising and implementing controls within those systems. Odi Turbo Bhd has an internal audit department which consists of eight staff, all of whom have been employed at Odi Turbo Bhd. for a minimum of five years and some for as long as 15 years.

The Chief Audit Executive (CAE-head of internal audit) appoints staff within the internal audit department. The Chief Executive Officer (CEO) is responsible for appointing the Chief Audit Executive (CAE). The Chief Audit Executive (CAE) reports directly to the Finance Director. The Finance Director also assists the Chief Audit Executive (CAE) in deciding on the scope of work of the internal audit department. Although, Odi Turbo Bhd. has a proper set up of audit committee which consists of three independent directors, most of the communication between CAE and audit committee is through the finance director or CEO. CEO also is responsible in approving the audit plan, audit report and also internal audit department budget. The termination and the bonus of CAE and the internal audit department is decided by the Managing Director, CEO and Finance Director.

You are an audit manager in the internal audit department of Odi Turbo Bhd. You are currently auditing the petty cash systems at the different branches. Your initial notes on petty cash contain the following information:

1. The average petty cash balance at each branch is RM6,000.
2. Average monthly expenditure is RM1,600, with amounts ranging from RM1 to RM600.
3. Petty cash is kept in a lockable box on a bookcase in the accounts office.
4. Vouchers for expenditure are signed by the person incurring that expenditure to confirm they have received re-imburement from petty cash.
5. Vouchers are recorded in the petty cash book by the accounts clerk; each voucher records the date, reason for the expenditure, amount of expenditure and person incurring that expenditure.
6. Petty cash is counted every month by the accounts clerk, who is in charge of the cash. The petty cash balance is then reimbursed using the 'imprest' system whereby a fixed amount is allocated for spending. The amount will be replenished and the journal entry produced to record expenditure in the general ledger.

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7. The cheque to reimburse petty cash is signed by the accountant at the branch at the same time as the journal entry to the general ledger is reviewed.

Required:

- (a) Explain the issues which limit the independence of the internal audit department in Odi Turbo Bhd. Suggest recommendations to overcome each issue.

(8 marks)

- (c) Explain the internal control weaknesses in the petty cash system at Odi Turbo Bhd. Suggest recommendations to overcome the weaknesses.

(12 marks)

(Total : 20 marks)

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